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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to Examine the Integration of Greenhouse Gas Emissions Standards into Procurement Policies.	CPUC Docket: R.06-04-009
AB 32 Implementation	CEC Docket 07-OIIP-01

RESPONSE OF CONSTELLATION NEWENERGY, INC., AND CONSTELLATION ENERGY COMMODITIES GROUP, INC. TO ALJ RULING REQUESTING COMMENTS ON TYPE AND POINT OF REGULATION ISSUES

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I. Introduction and Summary

On November 9, 2007, Administrative Law Judges Turkeurst and Lakritz issued a *Ruling Requesting Comments on Type and Point of Regulation Issues* ("ALJ Ruling") in order to address what they noted to be gaps in the record.[1] Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. (collectively, "Constellation") appreciate the opportunity to submit this response to the questions contained therein.

As a threshold matter, Constellation notes the following principles that govern its views regarding greenhouse gas ("GHG") emissions point of regulation for the electricity sector:

1. **Global linkage:** As noted throughout these comments, Constellation believes that ultimately effective progress on the reduction of GHG emissions will require coordinated regional, national, and ultimately international efforts.

[1] By email ruling on November 19, 2007 ALJ TerKeurst extended the deadline for filing these comments from November 28, 2007 to December 3, 2007.

Therefore, the programs that California adopts in its early efforts to yield emission reductions must carefully consider the ease with which its program will integrate with regional, national, and international efforts.

2. **Economy-wide:** Greenhouse gas emissions occur in multiple sectors of the economy, including electricity, transportation, commercial and industrial. Therefore, emission reduction strategies must be economy-wide for maximum effect.
3. **Market-based:** Setting an emissions cap and establishing a robust, liquid market-based cap-and-trade system will provide the most effective and efficient incentives for emission reductions, including incentives for technological innovation and prudent risk management.
4. **Clear and stable regulatory framework:** Investments in emission reduction technologies will be necessary to achieve the emission reduction goals. For investment to occur, the emission reduction programs must be sustainable over a relatively long time horizon so that investors have confidence that their investments and innovations will have economic value for the long term.

Consistent with these principles, Constellation believes that the following are key elements of a program that will result in genuine GHG emissions reductions:

1. **Source based:** The point of regulation should be the emission source – i.e., the program should be source-based.
2. **Output-based calculation of allowances:** Allowances to covered sources should be calculated utilizing an output-based methodology.
3. **Transition to full auction:** There should be a 50/50 split of allocation versus auction of allowance, transitioning over time to 100% auction.
4. **Cap-and-trade:** The predominant emission reduction strategy should be the implementation of a cap-and-trade program that will provide the transparent price signal necessary to optimize efficient investment.
5. **Incorporation of offsets:** Offsets should be an integral part of the emission reduction strategies.

Against this framework of principles and key program elements, Constellation offers the following responses to the questions posed in the ALJ Ruling.[2]

[2] Constellation notes, however, that the various pieces of AB 32 compliance will ultimately be integrated into a comprehensive whole, and as such, Constellation's views on any particular piece may change as specific comprehensive sets of rules are established.

II. Constellation Comments

3.1. General

Q1. What do you view as the incremental benefits of a market-based system for GHG compliance, in the current California context?

Absent a well-designed market-based system for GHG compliance, California will be forced to rely on command and control – regulatory and/or legislative mandates – to ensure compliance with the statutory requirements of AB 32. Command and control mechanisms tend to be burdened with administrative bureaucracies that can divert resources away from emissions reductions, and lead to less than optimal investment in GHG reduction technologies. On the other hand, a well-designed market-based cap-and-trade program as its foundation will allow competitive market forces to determine the most economic, efficient means for complying with the established cap and to provide tools that allow market participants to manage the risks associated with GHG emissions reduction compliance. Furthermore, because GHG emissions are a global issue, sustainable reductions will ultimately require global solutions. An international cap-and-trade program holds the most promise for establishing an international carbon market that enables development of the least cost, highest impact GHG reduction projects available around the world. While California strives to establish meaningful GHG reductions within its state borders, it must continue to recognize that its efforts are at the forefront of the emerging regional, national, and international responses to the problems of global warming, and therefore must ensure that its programs and market rules can be integrated in that broader context.

Q2. Can a market-based system provide additional emissions reductions beyond existing policies and/or programs? If so, at what level? How much of such additional emission reductions could be achieved through expansion of existing policies and/or programs?

See the Response to Q1.

3.2. Principles or Objectives to be Considered in Evaluating Design Options

Public Utilities Commission Staff proposes that the following principles or objectives be used to evaluate GHG program design options and to develop recommendations regarding a GHG regulatory approach. The objectives are not presented in any particular order.

- **Goal attainment: Does the approach being considered have any particular advantages in terms of meeting overall emission reduction goals? For example, does the approach have any advantages to promoting energy efficiency, combined heat and power, or renewable energy?**

- **Cost minimization: Is the approach likely to minimize the total cost to end users of achieving a given GHG reduction target?**

- **Compatibility with wholesale markets and the Market Redesign and Technology Upgrade: What are the implications of the approach on efficient functioning of wholesale markets generally and the California Independent System Operator day-ahead and real-time markets?**

- **Legal risk: Is the approach at greater relative risk of being delayed or overturned in court?**

- **Environmental Integrity: Does the approach mitigate or allow contract shuffling and the leakage of emissions occurring outside of California as a result of efforts to reduce emissions in California?**

- **Expandability: Would the approach integrate easily into a broader regional or national program? A related consideration is the suitability of the approach as a model for a national or regional program.**

- **Accuracy: Does the approach support accuracy in reporting and, therefore, ensure that reported emission reductions are real?**

- **Administrative Simplicity: Does the approach promote greater simplicity for reporting entities, verifiers, and state agency staff? How easy will the program design be to administer?**

Q3. Do you agree with this set of objectives? Are there other objectives or principles that you wish to see included? If so, please include your recommendations and reasoning. Finally, please rank the objectives above, and any additional factors you propose, in order of importance.

While Constellation believes that each of the listed objectives is important, Constellation would encourage the Commission to pay particular attention to the goal of expandability. As noted in the response to Q1, meaningful reduction in GHG emissions will require global efforts and therefore California's first mover efforts in the United States must keep at the forefront whether the mechanisms it is considering will be tenable and efficient on a regional, national, and international scale. Furthermore, issues associated with environmental integrity – contract shuffling and leakage – are only issues when neighboring regions have not established specific emission reduction goals, and thus are not unified in their efforts to combat global warming. Therefore as regional, national, and international efforts to combat global warming increase, the issues of environmental integrity will diminish.

Constellation also considers that compatibility with wholesale market design and MRTU to be a key objective because it will be through transparent wholesale market price signals that consumers and suppliers become fully aware of the costs associated with environmental improvement, and can make decisions at the wholesale and retail levels to manage those risks in the most economic fashion. Therefore, compatibility with wholesale markets/MRTU is integrally related with the objectives of goal attainment and cost minimization.

Constellation would rank these objectives in terms of how they are interrelated with one another. Specifically,

1. Expandability is a key objective, and is directly interrelated with environmental integrity.

2. Compatibility with wholesale markets/MRTU is a key component that directly relates to the efficiency with which the objectives of goal attainment and cost minimization are achieved.

3. Accuracy and Administrative Simplicity are important objectives to ensure that the costs of implementing compliance mechanisms are kept as low as possible.

With respect to the legal risks, Constellation has not conducted a specific legal analysis of the point of regulation issues or potential market-based systems that could be employed. However, Constellation would note that the issues under discussion here are largely related to public policy, and as such, legal challenges are likely to be brought by parties who oppose the underlying public policy. Environmental public policy that imposes realistic goals, assigns compliance responsibilities fairly, and provides access to market-based tools that allow obligated entities to manage the risks associated with compliance should withstand legal challenges.

3.3. Load-Based Cap-and-Trade System Design

Under a load-based approach, the regulated entities would be the retail providers of electricity to California consumers. Retail providers would be required to surrender allowances for the GHG emissions associated with all power sold to end users in California. Generators would not have a compliance obligation under this system, except possibly for exported power, as discussed in more detail below.

Constellation does not support a load based cap-and-trade system design because it is administratively complex and will not integrate well or easily with an emerging consensus that a cap-and-trade system should be source-based. Furthermore, it is inaccurate to think that generators will not have obligations under a load based system – while they may not have the direct compliance obligation, there can be no doubt that both electricity supply and demand resources must produce lower GHG emissions if reduction

goals are going to be met. Therefore, a load-based system that allocates allowances to retail providers who in turn make the determinations as to what emission reductions it prefers is likely to be inefficient. Finally, Constellation believes that significant concerns arise if the load-based design includes the allocation of allowances to retail providers. In its response to Q24 of the *ALJ Ruling Requesting Comments and Noticing Workshop on Allowance Allocation Issues*, Constellation enumerated its concerns with respect to the allocation of allowances to retail providers, and reiterates those concerns here:

> "Constellation is concerned about the allocation of allowances under the deliverer/first seller approach to the jurisdictional retail providers for subsequent auctioning to the deliverers/first sellers, for the following reasons:
>
> - First, allocating allowances to a jurisdictional retail provider – when the jurisdictional retail provider also owns emitting resources – would create a significant conflict of interest for the retail provider. Specifically, there would be a conflict between the retail provider's objective of selling the allowances at the highest price so as to maximize the revenues from the auction, and the objective of purchasing allowances for its owned and/or controlled generation at the lowest possible price to minimize its expenses. While auction rules could perhaps be developed to minimize the impact this inherent conflict may have on how the retail sellers conducted the auction, it is Constellation's opinion that it may be best to avoid this conflict altogether by having an independent entity conduct the auction.
>
> - Second, a jurisdictional retail provider would have a similar conflict if the retail provider's service territory allows retail choice or direct access. In this instance, the jurisdictional retail provider who runs the auction of the allowances, would have a conflict between maximizing the auction revenues and a potential desire to see the allowances sold at a lower price to the wholesale suppliers from whom it purchases energy so as to lower its costs vis a vis competitive retail suppliers, with an inappropriate and unintended [consequence] that the jurisdiction[al] retail provider's customers would have less incentive to choose an alternative supplier. Again, while auction rules could perhaps be developed to minimize the impact that such conflicts of interest may have on the conduct of the auction, Constellation believes that such conflicts may be best avoided by having an independent entity conduct the auction.

However, to the extent that it is determined that auction revenues should be directly returned to consumers through distribution rates, the jurisdictional retail providers are the appropriate conduit, and an [allocation] of allowances for re-auction could be considered. However, there would need to be in place specific provisions to ensure that the unintended outcomes described above could not occur."[3]

Q4. With a load-based cap-and-trade system, should exports from in-state generation sources be included and accounted for under the cap? Why or why not? If so, how? For example, exports could be captured in a cap-and-trade system by regulating in-state resources that export, or by counting the emissions associated with exported power, without any compliance obligation on the exporter. There may be other options as well.

To include exports from in-state generation sources under a load-based cap-and-trade system would require the cap to be partially sourced-based – in essence creating the need for two separate cap-and-trade systems – one to accommodate the load-based cap and another to accommodate the source-based system that captures the exports. This sort of complexity is among the reasons that Constellation urges the adoption of a source-based cap-and-trade system, with imports accounted for through a first –seller approach until the neighboring states in which the imported generation sources reside have adopted GHG emission reduction standards.

Q5. How extensive do you view the threat of contract shuffling under a load-based program, given the accessibility of clean resources within the western interconnect? What mechanisms do you propose to combat this possibility? On what basis do you support your position?

Contract shuffling will remain an issue with any state-wide load-based program, just as leakage would remain an issue under any state-wide source-based program. Regional, national, and ultimately international commitment to GHG emissions reductions will eliminate the geographic boundaries between states/nations that have an

[3] See *Comments of Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc. on ALJ Ruling Requesting Comments and Noticing Workshop on Allowance Allocation Issues,* submitted on October 31, 2007, pages 13-14.

emissions cap and those that don't, and eliminate the issues associated with contract shuffling and leakage. Hence the need to maintain a steady focus on promoting GHG emissions reductions at the regional, national and international level and implementing measures here in California that will integrate well with those efforts. In the meantime, the first-seller approach appears to hold the most promise for dealing with the issue of out-of-state power resources until neighboring states adopt their own GHG emission reduction standards.

Under a load-based system, three basic options may be used to match a retail provider's load to the sources of electricity used to serve the load: (1) the use of contracts and settlements data, (2) the development of a tracking system to facilitate matching sources to loads, with unclaimed sources pooled and assigned to all retail providers for any electricity that cannot be accounted for on a specified basis, and (3) the use of a tracking system and tradable emission attribute certificates (TEAC) to ensure that all electricity is assigned.

Q6. Which of these systems best accounts for all imports? What are the advantages and disadvantages of each potential tracking system in terms of accuracy, cost of development and administration of tracking systems, costs of administration to the parties, and overall costs to ratepayers? Are there alternative tracking approaches that you would recommend, and for what reasons?

If a load-based system is adopted (noting that Constellation supports a source-based system), a TEAC system seems to make the most sense for administering the cap and trade system, considering that this system could readily be standardized as is contemplated through Western Renewable Energy Generation Information System ("WREGIS") and/or The Climate Registry.

Q7. If a load-based approach is pursued, would the potential benefits of a full TEAC system be great enough to warrant the start-up and administrative costs?

Yes, (noting that Constellation supports a source-based system), Constellation believes that the incremental costs of implementing a TEAC system would be warranted,

especially if California utilizes an existing tracking mechanism such as WREGIS and/or the registry protocols of The Climate Registry which can be readily linked to other regional, national, and international tracking and verification platforms as they are formed.

3.4. Source-based Cap-and-trade System Design Options

3.4.1. Pure Source-based (GHG Regulation of In-state Generation Only)

Under an in-state-only source-based approach, the regulated entities would be the power plants located in California that generate electricity and emit GHGs. Under such a system, electricity use associated with imports would not be directly regulated under the cap-and-trade system. Instead, other policies and programs such as energy efficiency and the Renewable Portfolio Standard (RPS) would be utilized to decrease reliance on imported GHG-intensive power sources.

Q8. Do you view this approach as compliant with Assembly Bill (AB) 32? Please support your answer.

Constellation has not conducted a legal assessment of AB 32 as it related to a various forms of sourced-based and load based approaches to compliance.

The threat of leakage can be viewed over two time horizons: short-term and long-term.

Q9. In light of the relatively high capacity factors of carbon-intensive facilities outside the state, how extensive do you expect the short-term threat of substituting higher-carbon imports for in-state generation to be? Might this possibility be dealt with through specific program design (e.g., allocations, limiting conditions, etc.)?

Constellation has not seen or analyzed specific data on the capacity factors of carbon intensive facilities outside the state. It is likely, though, that an in-state-only sourced-based approach would increase the incentives for out-of-state units to operate at even higher capacity factors, if possible. Therefore, from a short term perspective (i.e, until neighboring states adopt GHG reduction targets and standards), the potential exists for generation from higher emitting out-of-state resources to be substituted for in-state

generation due to the relative advantage out-of-state generation will have absent the compliance costs of in-state generation. The potential for substitution will be limited only by the capacity of those out-of-state facilities and transmission constraints. However, implementation of the Environmental Performance Standard ("EPS") in response to SB 1368 already provides a significant amount of protection against the development of out of state high emitting resources that would sell their input into California, thus ameliorating this short term impact.

Q10. Given existing procurement oversight and the prospect for a regional or federal GHG program in the foreseeable future, how extensive do you expect the threat to be of a longer-term shift of production to regions beyond the reach of a California source-based cap-and-trade regime?

Constellation considers it extremely likely that there will be regional and national GHG emission reduction programs in the foreseeable future, and therefore does not believe that there is substantial threat of a long-term shift of production to regions outside the state. Furthermore, implementation of the EPS will mitigate any threat that does exist until regional and national systems are implemented.

Q11. If emissions associated with imported power are excluded from a cap-and-trade program, what policies beyond the existing suite of program including energy efficiency, California Solar Initiative, RPS, and Emission Performance Standard (EPS) do you recommend that California employ to achieve the necessary reductions from the electricity sector?

Constellation supports the first-seller approach (until there is a regional and/or national program) so that imports would not be excluded. However, if imports were to be excluded (perhaps due to legal restrictions), Constellation would be concerned that either increasing existing mandates, or implementing new command and control policies would undermine the efficacy of the state's cap-and-trade program, and thus should be avoided.

One area that should be given special attention in the event imports are excluded would be to adopt policies that create more incentives for offsets as a means of compliance with the cap.

Q12. As the Public Utilities Commission does not currently have authority to oversee all energy efficiency and renewable procurement programs for all kinds of retail providers (investor owned utilities (IOUs), community choice aggregators (CCAs), electric service providers (ESPs), and publicly owned utilities (POUs)), which agency(ies) should fill in any gaps? Which agency should be responsible for overseeing energy efficiency and renewable procurement for POUs? Would the California Air Resources Board (ARB) have the authority to require certain energy efficiency and renewable targets be met by POUs?

Constellation does not have a specific view on the jurisdictional issues associated with GHG emissions reductions or whether the extent of the authority that has been granted to ARB would allow it to impose specific energy and renewable targets on the POUs.

Q13. What sources would a source-based system cover? Could it cover California utility-owned facilities located outside of California?

Constellation does not have specific input to offer on whether the CPUC could assert jurisdiction over out-of-state generators that are owned by California utilities. However, Constellation notes that the implementation of the EPS provides significant control over out-of-state facilities owned by or under contract with in-state retail providers. Those measures provide meaningful protection against a large increase in the development of out-of-state high emitting resources to serve California's electricity needs.

Q14. Would a strengthened EPS assist in reducing emissions due to California imports? What recommended changes would you make to the EPS?

As noted in the response to Q11, Constellation believes that the implementation of command and control mechanisms, such as a more stringent EPS would ultimately undermine the efficacy of a cap-and-trade program and should be avoided. The existing EPS should provide the necessary protections until there is a robust regional and national cap-and-trade system.

3.4.2. Deliverer/First Seller

The term "deliverer/first seller" generally refers to the entity that first delivers or sells electricity into the electricity grid in California. For generation within California, the deliverer/first seller (the regulated entity) would be the generator, similar to a source-based system. For imported power, deliverer/first seller would be the entity that delivers the electricity into the California grid (the first sale within California), which could be a retail provider (an IOU, POU, ESP, or CCA) or wholesale marketer.

Q15. Please comment on the "First Seller Design Description" paper, which is Attachment A to this ruling. Does the paper accurately describe the deliverer/first seller program? If not, describe your concerns and include an accurate description from your perspective.

The paper appears to accurately describe the deliverer/first seller program.

3.4.3. Source-based for In-state Generation, Load-based for Imports

Under this approach, the point of regulation would be the electricity generators for in-state generation and the retail providers for imported power.

Q16. Please describe in detail your view of how this option would work.

This approach appears to be the converse of the approach discussed in Q4 (a load based system coupled with a source-based system for exported power). As noted in the answer to Q4, such a program would require the creation of two cap-and-trade systems – one that is source-based for the in-state generation, and one that is load-based to capture the imports. Constellation believes this unnecessary complexity can be avoided through

a first–seller approach until the neighboring states in which the imported generation sources reside have adopted GHG emission reduction standards.

Q17. Do you support such an approach? Why or why not?

Constellation believes that this approach is inferior to the first-seller approach, for the reasons explained in its answer to Q16.

Q18. Does this approach have legal issues associated with it? Provide a detailed analysis and legal citations.

Constellation has not performed a detailed legal analysis of the issues associated with one approach over another.

Q19. If retail providers are responsible for internalizing the cost of carbon for imported power, all power generated in-state may need to be tracked to load to avoid double regulation of in-state power. Do you agree?

Yes. Constellation agrees that the potential for double regulation of in-state power exists under this approach and that this complexity can and should be avoided through the adoption of a source based approach that employs a standardized tracking system, such as that contemplated under WREGIS and/or The Climate Registry protocols.

Q20. If that is the case, does a mixed source-based/load-based approach offer any advantages compared to a load-based approach in terms of simplifying reporting and tracking? What if the load-based system uses TEACs? How could imports be differentiated from in-state generation in a way that reduces the complexity of reporting and tracking compared to a load-based approach?

There does not appear to be any inherent advantage to this mixed source-based/load-based approach to a pure load-based approach since Constellation believes that a first-seller approach transitions to a full source-based system as regional and national source-based programs are implemented.

3.5. Deferral of a Market-based Cap-and-Trade System

In this scenario, a California-only cap-and-trade system would not be implemented for the electricity sector at this time. Instead, California would work with other Western states to develop a Western Climate Initiative cap-and trade system and/or work toward a national cap-and-trade program. In the meantime, existing policies and programs in the electricity sector may need to be ramped up to meet the AB 32 goals.

Several variations of this option may be possible. For example, a load-based cap could still be developed for retail providers, with assignment of individual entity obligations and trading available within the California electricity sector only, but not with other sectors. A second alternative would be to develop individual entity caps (or carbon budgets) which entities could not exceed without facing penalties or fees, but not allow for any trading of allowances at this time. Another option would be to ramp up the mandatory levels of existing programs such as the energy efficiency and RPS programs to higher goals, and make all retail providers obligated to meet these additional goals, without assigning specific cap levels to individual entities.

Before answering the specific questions with respect to the deferral of a market based cap and trade system, Constellation reiterates two core beliefs that (i) market based cap-and-trade systems will provide the most economic and efficient way to achieve meaningful GHG emission reductions, and (ii) long-term, sustainable GHG emission reductions on a global basis require regional, national, and international commitment and coordination. For California to continue to be a leader in the area of GHG emission reductions, it must proceed on two fronts: first, evaluating and implementing a cap-and-trade system that will work well in California and that can be seamlessly integrated into a regional, national, and international framework. Second, California must continue to use its strong leadership position to work with the Western Climate Initiative and in national forums to help shape and influence the development of market-based programs regionally, nationally, and internationally.

Q21. How important is it that a cap-and-trade system be included in the near-term as part of the electricity sector's AB 32 compliance strategy?

As noted in the introductory comments in this Section 3.5, Constellation believes that a market-based cap-and-trade program is critical to the state's achievement of the AB 32 goals at the least possible compliance cost to consumers.

Q22. Would your answer to Q21 be different if there is no market-based cap-and-trade system? If so, please explain.

Competition is a proven impetus for actual emission reductions because of its ability to provide incentives for both efficiency and technological innovation, which are critical for long-term GHG emissions reductions. Without a market-based cap-and-trade system, California will continue to rely on command and control systems that will reduce efficiencies and potentially limit technological innovations.

Q23. Address the following:

- **How emission reduction obligations could be met if there is no cap-and-trade system for the electricity sector,**

The ALJ Ruling cites several mechanisms that could be employed to ensure compliance with emission reduction goals, including assignment of individual entity obligations, with or without electricity sector trading, and/or ramping up mandatory levels of existing programs such as the energy efficiency and RPS programs to higher goals. Constellation would consider these types of mechanisms to be "command and control" approaches, and as noted throughout these comments, command and control strategies will be far less effective in achieving emission reductions and stimulating technological innovations than will market-based systems. Furthermore, while there is likely more that can be done with energy efficiency and renewables, these mechanisms

will have their limitations, as is evidenced by the increased attention to the real costs of wind power with respect to the need for services that can shape the wind power deliveries and ancillary services necessary to provide contingent power supply.

- **How increased programmatic goals would impact rates, and**

Constellation does not have the information necessary to determine the impact on consumer electricity rates from an increase in programmatic goals. However, for example, it is common knowledge that wind power costs are increasing significantly due to world-wide demand for turbines, which will have a marked impact on consumer rates as a result of continued reliance on wind generation to meet renewable energy goals. Furthermore, the additional costs of wind integration associated with shaping the power deliveries and providing adequate contingency reserves are proving to be significant as well.

- **How deferral of a cap-and-trade program for the electricity sector would facilitate or hinder California's integration into a subsequent regional or federal program.**

A decision now to defer design and implementation of a market based cap-and-trade program will likely hinder California's integration into subsequent regional or federal programs as other states or the federal government move forward with their respective programs. More importantly, it could result in the emission reduction goals of AB 32 being unmet or delayed.

Q25. If neither a regional system nor a national system is implemented within a reasonable timeframe, should California proceed with implementing its own cap-and-trade system for the electricity sector? If so, how long should California wait for other systems to develop before acting alone?

Constellation considers it highly likely that regional and national GHG emission reduction programs will be adopted in the near future and that such efforts will incorporate a market-based cap-and-trade program. Therefore, California's attention now to the development of well-designed framework for a market-based cap-and-trade program can serve as a model for the development of regional and national systems. If ultimately, there is no movement toward a regional or national cap-and-trade program, either because other approaches are adopted, or because there is a diminution of the urgency associated with GHG emission reduction, California's effort in this regard would need to be revisited.

Q26. What flexible compliance mechanisms could be integrated into a non-market based GHG emission reduction approach?

As noted throughout these comments, Constellation does not support non-market approaches to emission reduction programs. However, as noted in the response to Q11 the use of offsets and other flexible compliance tools will help to achieve emission reductions in a cost effective manner and should be incorporated into any emission reduction strategy, whether those strategies are market-based or not.

Q27. If a market-based cap-and-trade system is not implemented for the electricity sector in 2012, how would you recommend addressing early actions that entities may have undertaken in anticipation of a market?

Constellation believes that incentives for early action will be difficult to achieve absent a market based cap-and-trade system, and has not considered whether there are alternatives to address early action in a non-market based system.

3.6. Recommendation and Comparison of Alternatives

Q28. Submit your comprehensive proposal for the approach California should utilize regarding the point of regulation and whether California should implement a cap-and-trade program at this time for the electricity sector. If you recommend that another approach be considered besides those detailed above, propose it here. If you recommend one of the above options, give as detailed a discussion as possible of how the approach would work.

Constellation's comprehensive proposal is as follows:

1. The point of regulation is the in-state generating resources, and the first-seller for imports until neighboring states adopt their own emissions caps and emission reduction programs.
2. The total emissions of those emitting resources should be established as of the baseline year.
3. An equivalent amount of allowances should be established at the outset and 50% of those allowances should be allocated to the emitting resources without charge, based on output methodology. The remaining 50% of the allowances should be auctioned, with the auction open to all market participants who register to participate in the auction.
4. The pattern of the reduction in the number of available allowances on a year by year basis should be established and the percentage of the allowances that are allocated should diminish with a commensurate increase in the percentage that is auctioned, transitioning to a 100% auction.
5. Compliance mechanisms should be designed to provide flexibility through the use of offsets and length of the compliance period to allow for banking and borrowing of allowances.

Q29. Address and compare how each of the alternatives identified in the above questions, and the proposal you submit in response to the preceding question, would perform relative to each of the principles or objectives listed above and any other principles or objectives you propose. For each alternative, address important tradeoffs among the principles.

Constellation has not been able to prepare a specific response to this question.

Dated: December 3, 2007

Respectfully submitted,

/s/

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Certificate of Service

I hereby certify that I have this day served a copy of "Response Of Constellation NewEnergy, Inc., And Constellation Energy Commodities Group, Inc. To ALJ Ruling Requesting Comments On Type And Point Of Regulation Issues" on all known parties to R.06-04-009 by transmitting an e-mail message with the document attached to each party named in the official service list. Parties without e-mail addresses were mailed a properly addressed copy by first-class mail with postage prepaid.

Executed on December 3, 2007 at Sacramento, California

/s/

Eric Janssen

R.06-04-009
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December 3, 2007

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